No. 10434

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

JOSEPHINE WELCH OVERTON, as Executrix of the Estate of Galen H. Welch, deceased, formerly Collector of Internal Revenue for the Sixth Collection District of California,

Appellant,

vs.

MAE H. SAMPSON, individually and as Executrix under the will of W. O. SAMPSON, deceased,

Appellee.

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

BRIEF FOR THE APPELLEE.

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FILED
SEP 25 1943
PAUL P. O'BRIEN,
CLERK

Parker & Baird Company, Law Printers, Los Angeles

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vs.

MAE H. SAMPSON, individually and as Executrix under the will of W. O. SAMPSON, deceased,

Appellee.

BRIEF FOR THE APPELLEE.

Questions Involved.

1. DID THE AMENDMENT IN 1927 TO THE CALIFORNIA CIVIL CODE, §161 (a) CONFER UPON THE WIFE, DOMICILED IN CALIFORNIA, SUCH AN INTEREST IN CALIFORNIA COMMUNITY PROPERTY AS WARRANTED THE EXCLUSION OF HER INTEREST IN THE COMMUNITY PROPERTY FROM THE ESTATE OF THE HUSBAND FOR FEDERAL ESTATE TAX PURPOSES?

2. UNDER THE LAW OF CALIFORNIA MAY A HUSBAND DOMICILED IN CALIFORNIA, BY AGREEMENT TRANSMUTE PROPERTY FROM ONE TYPE INTO ANOTHER TYPE?

3. Did the appellee acquire under the terms of the agreement dated May 23, 1929, between herself and her husband such an interest in their property as to entitle her to have her one-half of the community property excluded in computing the Federal estate tax on her deceased spouse's estate?

Statutes and Regulations Involved.

In addition to the statutes set forth in the Appellant's Brief there is included in the Appendix annexed hereto a copy of Sections 401 and 402 of the Revenue Act of 1942, and §158 of the California Civil Code.

Statement.

The appellee would like to supplement the statement set out in the Appellant's Brief as follows:

The decedent was Secretary and Treasurer of Bullock's [R. 197]. He attended business every day and worked long hours. He was taken ill about the 15th or 16th of November, 1930 [R. 198]. He was in good health at the time the agreement of May 23, 1929, was made [R. 197]. The decedent died of Lobar pneumonia [R. 199] on the 28th day of December, 1930 [R. 193]. In the early part of November, 1930, the decedent took out $30,000 of life insurance in the New England Mutual Life Insurance Company [R. 203].

The case was tried before Hon. Albert Lee Stephens on December 14, 1936, without a jury [R. 119]. It was then transferred to the Hon. Ralph E. Jenney, who, on the 30th day of April, 1938, handed down an extensive opinion, which was vacated by Judge Jenney of his own motion under date of January 9, 1941 [R. 49].

ARGUMENT.

I.

Section 161 (a) of the Civil Code of California Gives the Wife a Vested Interest in Community Property Acquired After the Effective Date of Its Adoption.

The Appellant's Brief devotes a great deal of space to reviewing authorities which treat of the nature of community property owned by spouses domiciled in California before July 29, 1927.

In 1926 the Supreme Court of California, in the case of *Stewart v. Stewart,* 199 Cal. p. 318, held in effect that the wife's interest in community property was not vested.

The nature of a wife's interest in California community property had been the subject of considerable litigation and the decisions and rulings of the Treasury Department were far from consistent. Thus in the case of *Wardell v. Blum* (C. C. A. 9), 276 Fed. 226, certiorari denied, 258 U. S. 617, it was held that a wife took a one-half interest in her own right in community property under the 1917 amendment to the California Inheritance Tax Act. This case was decided in 1921. In 1924 the United States Attorney General issued two decisions, one T. D. 3569 III-1 C. B. 91 and the other T. D. 3670 IV-1 C. B. 19, in which it was held that only one-half of the community property was taxable upon the death of the husband. In 1926 the tide flowed in the opposite direction and by T. D. 3891 V-2 C. B. 232 the Treasury Depart-

ment ruled that the community property was taxable in full to the estate of the husband and it was so held by the Ninth Circuit in *Talcott v. United States,* 23 F. (2d) 897 (1928), certiorari denied 277 U. S. 604.

Then came Section 161 (a) of the California Civil Code, which provides that during the continuance of the marriage relation the wife's interest in the community property was a "present, existing and equal interest." See page 1 of Appendix of Appellant's Brief. There had been a good deal of controversy about the wife's right to report one-half of the community income for income tax purposes as well as having one-half of the community property excluded from the husband's estate for Federal estate tax purposes. That the amendment was designed to accomplish this purpose is clearly disclosed by the case of *United States v. Malcolm,* 282 U. S. 792 (1931). This case involved the question of the right of a wife to report one-half of the community income on her separate return. The case went up to the Supreme Court on a certificate from the United States Circuit Court of Appeals for the Ninth Circuit and concerned a husband and wife who were domiciled in California. The Supreme Court answered in the affirmative the following question:

> "Has the wife, under Section 161 (a) of the Civil Code of California, such an interest in the community income that she should separately report and pay tax on one-half of such income?"

In support of its answer the Court cited *Poe v. Seaborn,* 282 U. S. 101; *Goodell v. Koch,* 282 U. S. 118; and

Hopkins v. Bacon, 282 U. S. 122. In the case of *Poe v. Seaborn* the Court arrived at its conclusion upon the ground that a wife had a vested property right in the community property equal with that of her husband. Speaking of the power of the husband over the community property the Court said:

> "The law's investiture of the husband with broad powers by no means negatives a wife's present interest as a co-owner."

The rule in the *Malcolm* case has remained undistributed for a period of twelve years and it has been the practice of the Treasury Department since that decision to accept without question separate returns of husbands and wives domiciled in California, each reporting one-half of the new type community income upon separate returns. The theory of the *Malcolm* case, of course, is that California wives have a vested interest in one-half of the earnings of husbands after July 29, 1927. This also applies to income derived from community property acquired with such earnings. In the present instance the parties entered into an agreement under date of May 23, 1929, by which they converted all of their property under the new type community property.

II.

It Is Immaterial Whether the Property Was Community Property Earned After July 29, 1927, or Was Converted to That Type of Property by the Agreement.

The appellant has attempted to establish some nebulous distinction between the "pre-1927" type of community property and the separate property of the decedent on the one hand, and the new type of community property acquired after July 29, 1927, with earnings made after that date. She admits that one-half of the community property acquired from earnings of the decedent after July 29, 1927, should not be included whereas she earnestly contends that all other property acquired by the decedent should be included in the decedent's estate. There seems to be no question of the right of spouses domiciled in California to convert one type of property into another by agreement. See §158 of the *California Civil Code* [see Appendix]; *Schuler v. Savings Fund & Loan Society,* 64 Cal. 397 (1883); *Title Insurance and Trust Company v. Ingersoll,* 153 Cal. 1 (1908); *Estate of Sill,* 121 Cal. App. 202 (1932) and GCM 669 V-2 C. B. 111.

There seems to be no doubt that the Sampson agreement was effective to convert all property owned by Mr. Sampson into the new type of community property. To hold otherwise would necessitate the overruling of a long line of California cases.

The appellant attempts to differentiate between (a) community property acquired prior to 1927 and separate

property, and (b) community property acquired out of post-1927 earnings. After a metaphysical disquisition upon the subject of control and management of pre-1927 community property, the appellant comes to the conclusion that this control and management requires the inclusion of all of the old type community property in a husband's estate. See pages 17 to 27 Appellant's Brief. This conclusion, of course, is arrived at after the appellant admits that one-half of the post-1927 community property should not be included in the husband's estate, and *yet the decedent's right of control and management over both the old and new type of community property was identical* not only under the terms of the agreement but by virtue of Section 161 (a) of the Civil Code. See *Bank of America National Trust & Savings Association v. Rogan,* 33 Fed. Supp. 183 (1940). Incidentally, the agreement affected not only property owned on May 23, 1929, but all property whether theretofore acquired or thereafter to be acquired.

In discussing the degree of control or management exercised by a husband over community property in California, the appellant overlooked the practical aspect of the relationship of spouses and their property. Ordinarily spouses do not deal with each other with respect to their property at arms length. The terms "mine" and "yours" disappear and they become "ours." It is not an uncommon thing for a husband to exercise the same control and management of his wife's separate property as he does with respect to the community property. Cer-

tainly this would not be a reason for including the wife's separate property or any part of it in the husband's estate. It is submitted that tenuous speculations should not be permitted to destroy the right of a wife under the California law in community property. As was said by the District Court in the case of *Bank of America etc. v. Rogan, supra:*

> "This makes it unnecessary to deal with some of the other theoretical and abstract considerations and arguments as to the nature of community property ownership to be found in the writings of taxation experts and some court decisions. By dissecting our community property law and subjecting it to various categorical tests, one could easily pulverize and reduce to naught the interest of the wife, so as to deprive California wives, for taxation purposes, of the benefits which communal ownership confers upon them. We prefer to deal with realities."

III.

The Agreement of May 23, 1929, Was Not Made in Contemplation of Death.

The lower Court found that the agreement of May 23. 1929, was not made in contemplation of death [R. 96, 101]. This finding is amply supported by the evidence which showed that Mr. Sampson was actively engaged in business up to within six weeks of his death, and less than two months before his death he effected life insurance in the sum of $30,000 upon his life and that the cause of his death was Lobar pneumonia. There was no conflict in the evidence upon the point and it would seem clear that the finding was well founded.

IV.

The Commissioner of Internal Revenue Has Acquiesced in the Case of Bigelow v. Commissioner Following the Goodyear Case.

The judgment in the *Goodyear* case was entered in 1937 by the District Court. This judgment was affirmed on October 18, 1938, by the Circuit Court of Appeals for the Ninth Circuit. No application for certiorari was made. Thereafter the United States Board of Tax Appeals in the case of *Bigelow v. Commissioner,* 39 B. T. A. 635 (1939) followed the *Goodyear* case (99 Fed. (2d) 523), and in the latter part of 1939 the Commissioner of Internal Revenue acquiesced in the decision of the Board in the *Bigelow* case (1942-2 C. B. 2). The significance of this acquiescence will be found in 1941-2 C. B. p. IV as follows:

> "Decisions so acquiesced in should be relied upon by officers and employees of the Bureau of Internal Revenue as precedents in the disposition of other cases before the Bureau."

The Commissioner's acquiescence in the *Bigelow* case apparently has never been withdrawn and it still serves as a precedent in settling estate tax cases involving the same issues now before this Court. As a matter of fact a number of cases involving the identical issue have been settled by the Department in favor of taxpayers.

It might be well at this point to direct the Court's attention to the fact that the agreement in the *Bigelow*

case is practically identical with the Sampson agreement except for a change of names and dates. The Bigelow agreement will be found in 38 B. T. A. 378.

It would not seem unreasonable on the part of the taxpayer to expect the Treasury Department to adopt some consistent position with respect to the question here involved and it is certainly not consistent for the Department to pursue this case with the vigor it has in the face of the acquiescence in the *Bigelow* case.

V.

The Law of the State of the Domicile of the Taxpayer Is Controlling in Determining the Nature of Property Interests for Taxation.

The appellant advances the view that the residents of community property states enjoy tax advantages that "should be restricted in so far as they may be consistent with well settled judicial principles." It is submitted that this can only be interpreted as an invitation to this Court to indulge in judicial legislation. Counsel for the appellant cannot be unaware of the fact that this question as to the so-called advantages of the community property states has been the subject of extensive discussion in Congress for a number of years. The acquiescence of Congress in the *Goodyear* case has not merely been passive. It has repeatedly declined to amend the Revenue Law so as to deprive spouses in community property estates of the right to report community income on separate returns and to have the wife's share of any com-

munity property excluded from the husband's estate for Federal estate tax purposes. It was not until the Revenue Act of 1942 was adopted that Congress took any action to include the wife's share for estate tax purposes. The Act made no change as to income tax on community income. In passing it may be noted that the effectiveness of §401 and §402 of the Revenue Act of 1942 relating to the matter have already been questioned by the Supreme Court of Louisiana June 21, 1943, in the *Matter of Succession of Sam Wiener, Jr.* reported in Prentice-Hall Inheritance and Transfer Tax Service, 11th Edition, par. 1103.

Having failed after years of effort to induce Congress to take some action in the premises, the representatives of the taxing authorities in this case are now seeking to induce this Court to do what Congress has refused to do. If the Court should adopt the contention of the appellant it will necessitate the overruling of the *Goodyear* case, the *Lang* case, the *Bigelow* case, *Poe v. Seaborn, Malcolm* case, *Bank of America v. Rogan* and a number of other cases involving this same point. It would also be necessary to overturn the Treasury Department's own policy of following the *Bigelow* case.

VI.

Congress Has Indicated by the Revenue Act of 1942 That It Has Approved the Exclusion of One-half of the Community Property From the Estate of Husbands Dying Prior to the Effective Date of the 1942 Act.

As hereinbefore pointed out the *Goodyear* case was affirmed in October, 1938. Since then Congress has enacted at least six Internal Revenue laws without changing the rule of the *Goodyear* case in so far as decedents dying before the effective date of the Revenue Act of 1942. Reference to §401 and §402 of the Revenue Act of 1942 seems clearly to indicate that Congress had no intention of abrogating the Goodyear rule retroactively because §402 of the Revenue Act of 1942 is made applicable only to estates of decedents dying after October 21, 1942. This was no mere oversight on the part of Congress. It is a matter of common knowledge that for a number of years the various aspects of community property systems and their relationship to the revenue laws have been the subject of a great deal of discussion in Congress. Even to this day Congress has refused to interfere with the rule as established by the *Malcolm* case of community income for income tax purposes.

VII.

The Case of Helvering v. Hallock Is Not in Point.

The appellant discusses the case of *Helvering v. Hallock,* 309 U. S. 106 and relies heavily on it in support of her contentions. In that case the decedent created a trust under which his wife was a life tenant. The trust provided that if the wife predeceased the husband, the corpus was to go to him, if surviving, if not then to third persons. It is submitted that this state of facts is in no wise comparable to those present in the case at Bar. The *Hallock* case was a five to four decision which overruled two previous five to four decisions which ruled in favor of taxpayers. It will be noted that whatever rights Hallock had in the nature of a reversionary interest in the trust property were created by Hallock himself by the trust indenture. In the present case, Mr. Sampson's interest in the community property, in the event Mrs. Sampson predeceased him, did not flow from the agreement of May 23, 1929, but from *§1401 of the Civil Code* (now §201 of Probate Code), which is a succession statute. Had Mrs. Sampson died testate before Mr. Sampson, there was nothing to prevent her from making a testamentary disposition of all of the property affected by the agreement. See §201 of the Probate Code. Nor could Mr. Sampson bequeath or devise Mrs. Sampson's share of the community property without her acquiescence. In other words Mr. Sampson's rights were derived from the Probate Code and not from the agreement. Mrs. Sampson alone had power to determine whether Mr. Sampson

should receive the property at her death, whereas, in the *Hallock* case the wife had no say as to this.

If the *Hallock* case bears the interpretation urged by the appellant, there never could be an outright gift between closely related persons. Take for example the case of an outright gift by a parent to a child without issue. The child might die intestate and the parent would inherit by reason of the succession laws. This is particularly true if the child happens to be a minor legally incapable of making a will. Does the possibility that a donor may inherit donated property from the donee justify the inclusion of such property in the donor's estate? Yet this is what would happen if the appellant's theory of the *Hallock* case is adopted.

VIII.

The Appellant's Theory of the Case on Appeal Differs From That Upon Which the Case Was Tried.

The Appellant's Brief clearly exemplifies the inconsistent position which the Treasury Department has taken with respect to the question here involved. On page 8 of the brief the appellant makes it clear that the appeal involves only the decedent's separately owned property and "pre-1927" community property. On page 12 of the Appellant's Brief appears the statement:

> "Nor do we contend that the full value of community property acquired with the husband's earnings after July 29, 1927, is includible in his gross estate."

It is believed that this is the first time the appellant has conceded this point in this case. The Commissioner of Internal Revenue rejected the appellee's claim for refund *in toto* and now after more than six years of litigation in which the enormous resources of the United States of America were opposed to the appellee and after the dollar has shrunk appreciably in value, the appellant now admits that even if she is successful on this appeal, a judgment of $680.00 would be proper. See page 2 of Appellant's Brief.

Conclusion.

For the reasons stated above it is respectively submitted that the judgment of the Court below should be affirmed.

Frank Mergenthaler,
Attorney for Appellee.

APPENDIX.

Revenue Act of 1942, Title IV—Estate and Gift Taxes
Part I—Estate Tax

Sec. 401. Estates to Which Amendments Applicable.

Except as otherwise expressly provided, the amendments made by this Part shall be applicable only with respect to estates of decedents dying after the date of the enactment of this Act.

Sec. 402. Community Interests.

(a) Transfers of Community Property in Contemplation of Death, etc.—Section 811 (d) (relating to revocable transfers) is amended by adding at the end thereof the following new paragraph:

> "(5) Transfers of Community Property in Contemplation of Death, etc.—For the purposes of this subsection and subsection (c), a transfer of property held as community property by the decedent and surviving spouse under the law of any State, Territory, or possession of the United States, or any foreign country, shall be considered to have been made by the decedent, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse."

(b) General Rule.—Section 811 (e) (relating to joint interests) is amended as follows:

(1) By striking out "(e) Joint Interests.—" and inserting in lieu thereof

"(e) Joint and Community Interests.—

"(1) Joint Interests.—".

(2) By inserting at the end thereof the following new paragraph:

"(2) Community Interests.—To the extent of the interest therein held as community property by the decedent and surviving spouse under the law of any State, Territory, or possession of the United States, or any foreign country, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse. In no case shall such interest included in the gross estate of the decedent be less than the value of such part of the community property as was subject to the decedent's power of testamentary disposition."

Civil Code of California (1935):

§158. Husband and Wife May Make Contracts. Either husband or wife may enter into any engagement or transaction with the other, or with any other person, respecting property, which either might if unmarried; subject, in transactions between themselves, to the general rules which control the actions of persons occupying the confidential relations with each other, as defined by the title on trusts.